COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE TARIFF APPLICATION OF KENTUCKY-)
AMERICAN WATER COMPANY PROCEDURE) CASE NO. 10423
FOR COMPUTING REVENUE REQUIREMENTS)

O R D E R

Background

On October 27, 1988, Kentucky-American Water Company ("Kentucky-American") filed a proposed tariff, Computation of the Revenue Requirement Applicable to the Improvements Authorized by a Certificate of Convenience and Necessity in Case No. 10365.[1] This tariff, if accepted, would allow Kentucky-American to adjust its rates, outside of a general rate case, to include the additional revenue requirement associated with the 30-inch raw water main authorized by this Commission in Case No. 10365.

Kentucky-American stated that the tariff was needed for it to earn a return on this investment in a timely manner. Kentucky-American also stated that if the tariff was accepted in this case, a similar tariff would be filed to allow for an adjustment of rates to include the additional revenue requirement associated with the improvements to the Richmond Road treatment plant and the

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1 Case No. 10365, Application of Kentucky-American Water Company for a Certificate of Public Convenience and Necessity Authorizing the Construction of Approximately 35,000 Feet of 30 Inch Raw Water Transmission Facilities.

initial construction of the Kentucky River Station II with the associated pipeline.

A public hearing was scheduled and held on March 22, 1989, at the Commission's offices in Frankfort, Kentucky. Intervening in this proceeding and participating at the hearing were the Attorney General's Utility and Rate Intervention Division and the Lexington-Fayette Urban County Government ("AG/LFUCG"). Witnesses appearing on behalf of Kentucky-American were: Roy L. Ferrell, assistant treasurer of Kentucky-American and director of Rates and Revenues for the Southern Region of American Water Works Service Company; and Chris E. Jarrett, vice president and treasurer of Kentucky-American Water Company. Appearing on behalf of the AG/LFUCG was James W. Freeman, associate professor at the University of Kentucky, College of Business and Economics.

Simultaneous briefs were filed by Kentucky-American and the AG/LFUCG on March 31, 1989. All additional information requested at the hearing has been filed.

Discussion

In support of its proposed tariff, Kentucky-American stated that this filing was being used as a "bellwether" or "trial balloon"[2] in an effort to receive philosophical approval of this method of recovering a revenue requirement associated with capital investment. If this method is approved, Kentucky-American would file similar tariffs for its Kentucky River Station II construction project.

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2 Kentucky-American's Brief filed March 31, 1989, page 1.

Since that project and the improvements to the Richmond Road treatment plant, as well as the 30-inch raw water main, would require a substantial investment in plant, nearly doubling the current investment in plant in service, Kentucky-American felt that traditional methods of rate-making would not allow them sufficient opportunity to earn an authorized rate of return. Under traditional rate-making methodology, Kentucky-American predicts that it ". . . will only earn approximately two-thirds of what it is authorized to earn as an average for the next four years . . . ."[3] This is due primarily to the lag between the time an investment is made in plant and rates are adjusted to reflect a revenue requirement associated with that investment.

Kentucky-American proposed this tariff in an attempt to either eliminate or substantially reduce this delay. Without this relief, Kentucky-American has stated that it will be necessary to file at least seven additional rate cases over the next 4 years in order to maintain its financial integrity.

In opposition to the tariff the AG/LFUCG stated that:

1. Kentucky-American's situation is not unique and that larger construction projects have been examined without a change in the historical test-year concept.

2. The Commission should not accept this tariff outside of a full generic administrative proceeding since it would establish a precedent for other utilities.

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3 Ibid., page 4.

3. It is not necessary to deviate from established rate-making methodology in this particular instance since Kentucky-American's $2 million investment in the 30-inch raw water main is neither burdensome nor unique.

4. Since the Commission allows, but does not guarantee, an authorized rate of return, inability to earn that return is insufficient grounds on which to allow a deviation.

The Commission agrees with the AG/LFUCG's position that a deviation from traditional rate-making methodology is not warranted for Kentucky-American's investment in the 30-inch raw water main. Nor would the 30 days' notice, prior to future tariffs going into effect, allow the Commission adequate opportunity to fully review the proposed tariff, the additional investment in plant, and its associated revenue requirement. Any additional suspension period required would tend to negate Kentucky-American's purpose for requesting deviation, to substantially reduce or eliminate regulatory lag. Therefore, the Commission is of the opinion that the proposed special tariff should be denied.

This does not preclude Kentucky-American from investigating and pursuing other alternatives, such as the inclusion of committed construction in rate base, as currently proposed in Case No. 10481[4] or filing a general rate case based on a future or projected test period.

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4 Case No. 10481, Notice of Adjustment of Rates of Kentucky-American Water Company effective on February 2, 1989.

IT IS THEREFORE ORDERED that Kentucky-American's proposed tariff be and it hereby is denied.

Done at Frankfort, Kentucky, this 9th day of May, 1989.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director